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No. 85- 36

IN THE

Supreme Court of the United States

OCTOBER TERM, 1985

MICHAEL CEASAR,

Petitioner,

-against-

MERRILL LYNCH & CO., INC., ROGER E. BIRK, DAKIN B. FERRIS and WILLIAM A. SCHREYER,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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QUESTIONS PRESENTED

1. Whether plaintiff's complaint pleaded fraud with particularity sufficient to: (i) satisfy the pleading requirements of F.R.C.P. 9(b); and (ii) defeat defendants' motion to dismiss converted into a motion for summary judgment, where the rigid pleading requirements of the case relied on by the Second Circuit in terming this case "fraud by hindsight" are not followed by other Circuits and have been disavowed by scholarly writers.

2. Whether the Circuit Court erred in affirming the District Court's grant of summary judgment at the pleading stage of a securities fraud action where: (i) the pleadings, and documents sought to be presented, raised genuine issues of material fact concerning

defendants' conduct; (ii) the facts concerning the alleged fraud are peculiarly within the defendants' knowledge; and (iii) plaintiff was denied discovery, sought in order to oppose summary judgment.

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-against-

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Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

Petitioner Michael Ceasar, respectfully prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Second Circuit entered in this proceeding on April 8, 1985.

OPINIONS BELOW

The order of the United States District Court for the Eastern District of New York is unreported. The decision of the United States Court of Appeals for the Second Circuit, affirming said order, is unreported. The decisions of both the Second Circuit and the District Court are set forth in the Appendix (A-6-8, 20-23).

JURISDICTION

This Petition for Certiorari is filed pursuant to 28 U.S.C. § 1254(1). Federal jurisdiction was invoked in the United States District Court under Section 27 of the Securities Exchange Act of 1934 (the "Act") (15 U.S.C. § 78aa), as amended. The order of the District Court granting summary judgment to defendants was timely appealed to the

Second Circuit. The Second Circuit affirmed on April 8, 1985.

STATUTORY PROVISIONS INVOLVED

Involved in this case are Section 10(b) of the Securities Exchange Act of 1934 (15 U.S.C. § 78j(b)), Rule 10b-5 of the Securities and Exchange Commission (17 CFR 240. 10b-5), Rules 1, 8, 9(b), 12, 16, 26, 56 and 60(b) of the Federal Rules of Civil Procedure ("F.R.C.P.") and the Rules Enabling Act. These are set forth in the Appendix (A-208-216).

STATEMENT OF THE CASE

This action was brought to enforce defendants' liability for misconduct created by Section 10(b) of the Act and Rule 10b-5, promulgated thereunder. It is based upon alleged wrongdoing concerning Merrill Lynch & Co., Inc.'s

("Merrill Lynch") published financial statements for the first and second quarters of 1983. These publicly disseminated and filed documents were silent as to Merrill Lynch's exposure for huge losses as a result of its substantial sales of Baldwin United Corporation's ("Baldwin") single premium deferred annuities ("SPDAs") and its status as a large creditor of Baldwin.

Plaintiff purchased 100 shares of Merrill Lynch on July 5, 1983, 100 shares on July 28, 1983 and 150 shares on September 13, 1983 (A-30). Said purchases were made at prices artificially inflated by the defendants as a result of false or misleading statements in, or material omissions from, Merrill Lynch's first two 1983 quarterly financial reports disseminated to shareholders and the financial community. The first

purchase was made after dissemination of the 1983 first quarter report, which claimed record earnings (A-59-60) and, after announcement of glowing prospects for the future (A-38). Plaintiff's additional purchases were made while he was a stockholder and after the issuance of the second quarter report, which claimed record earnings for the second quarter and first half of 1983, resulting from a "generally very strong showing in the great majority of our activities." (A-60-62).

The facts set forth in the complaint* disclose that prior to plaintiff's purchases, Merrill Lynch was "intimately familiar with the financial condition of

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* All references to the complaint refer to the amended complaint, which was filed as a matter of right, and is set forth in the Appendix without exhibits.

Baldwin and its subsidiaries" (A-42) through the sale it made to Baldwin of AMIC Corp. (A-42) and its participation in the MGIC Corp. sale to Baldwin (A-44). As a result of the AMIC sale, Merrill Lynch became a creditor and holder of approximately $90 million in notes of Baldwin and monitored its deteriorating financial condition (A-43).

The complaint further set forth such evidentiary allegations as that Baldwin had purchased MGIC Investment Corp. for $1.2 billion and arranged bank loans of over $.5 billion in order to pay for such purchase (A-44); that in 1982, Baldwin, to the knowledge of Merrill Lynch, was unable to meet the targeted payment dates it established for such purchase; and that Merrill Lynch participated in and aided in such acquisition which it thereafter moni-

tored (A-44-45). The complaint further alleged that Baldwin subsidiaries were paying higher interest to SPDA holders during the period 1979-1983 than Baldwin was earning on its investments, thus losing money on each SPDA sale (A-46-48); that Merrill Lynch disregarded special reports available to it, but not to plaintiff, which "specifically described the illiquidity and problems" of Baldwin (A-51); that Merrill Lynch violated state statutes and regulatory requirements and federal law (A-51-52); that various state regulatory authorities began investigations which resulted in remedial orders and limitations (A-50-52); and that Merrill Lynch was selling unregistered securities of Baldwin (A-36-37, 51-52).

The complaint particularized facts such as that Merrill Lynch failed to disclose the adverse impact Baldwin's

increasingly poor financial condition would have upon Merrill Lynch's financials (A-62-64); that Baldwin was unable to meet the payments owed to Merrill Lynch under the terms of the AMIC sale (A-41-43, 62-63); that, prior to September 1982, the State of Texas had refused to allow Baldwin to register securities because of the inability of Baldwin to meet its debt obligations (A-50); that Merrill Lynch's sales tools which it used in selling Baldwin SPDAs were misleading (A-53); and the reasons therefor (A-54-56).

The comlaint sets forth the bases for Merrill Lynch's knowledge of the facts alleged with such great particularity in the complaint or for its reckless disregard of such facts, noting that by reason of its being a substantial and continuing creditor of Baldwin and by virtue of its superior research and

analysis activities concerning the financial difficulties of Baldwin and Baldwin's inability to meet its obligations Merrill Lynch knew or should have known of the foregoing facts (A-56-57). Finally, the financial difficulties Baldwin faced, as disclosed by regulatory proceedings concerning six of its subsidiaries and the actions taken by certain regulatory authorities, alleged to have been known by Merrill Lynch, were factually set forth in detail in the complaint (A-56-57). Moreover, all of the allegations of the complaint were supported by the exhibits annexed thereto.

Within 10 days of plaintiff's last purchase, the Factor lawsuit against Merrill Lynch and others, brought on behalf of Baldwin SPDA purchasers, was announced. The stock price of Merrill Lynch fell (A-68). In support of his

allegation of damages suffered, plaintiff submitted the affidavit of a damage expert.

Within four months of plaintiff's last purchase, Merrill Lynch announced that it had charged off $154 million (pre-tax) against its 1983 earnings, including its reported record earnings of the first and second quarters upon which plaintiff had relied in making his successive purchases. Merrill Lynch stated that $88 million of the $154 million was charged off in order to pay persons who purchased Baldwin SPDAs from Merrill Lynch. An additional $66 million was stated to have been taken as a reserve against the debt owed by Baldwin to Merrill Lynch as a result of Merrill Lynch's direct transactions with Baldwin by which Merrill Lynch became a Baldwin creditor (A-68-69).

Both the original and consolidated amended Factor complaints were before the courts below, as was Merrill Lynch's answer* to the latter. Exhibits annexed to plaintiff's complaint confirmed that Merrill Lynch had set aside monies to recompense Baldwin SPDA purchasers to whom it had sold securities; disclosed Wall Street's startled reaction to the setting aside of "88 million as partial reimbursement for its customers who bought" Baldwin SPDAs and the observation by others that Merrill Lynch's plan to partially reimburse SPDA purchasers was "a recognition by the company [Merrill

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* Merrill Lynch originally claimed that it was unable to answer the Ceasar complaint although it had no trouble answering the Factor complaint containing similar allegations. The only major difference being that the complaints were brought on behalf of different classes each of which was injured by the same wrongs.

Lynch] that it is on shaky legal ground" and "is very concerned about its liability"; and disclosed the fact that Merrill Lynch, among other firms, by proposing partial re-payment was trying to persuade SPDA holders who had filed 51 different Federal Court lawsuits to drop them.

The record below also includes the facts that Baldwin had sold 163,000 SPDAs with a value of $4.2 billion; that SPDAs were sold to more than 40,000 people; and that Merrill Lynch was the biggest marketer of these SPDA sales. Most importantly, plaintiff presented factual evidence to the Court below that in January 1983 and prior thereto, many other large brokerage houses, including Prudential Bache, Bear Stearns & Co. and Smith Barney, Harris Upham & Co., instructed their brokers to "defer active marketing" of Baldwin SPDAs (A-52).

Merrill Lynch, however, continued to actively sell them, despite the fact that analysts and rating services had lowered their ratings on Baldwin securities partly because Baldwin had deferred the date of payment of its obligations on its MGIC investment; and despite Merrill Lynch's knowledge of Baldwin's illiquidity and other problems.

The record below also included at least fifteen (15) negative articles concerning Baldwin published between January 1983 and April 15, 1983 when Merrill Lynch, acknowledging the serious risks involved, first told its salespeople to stop selling the Baldwin SPDAs. These articles referred to stock fluctuations causing material concern among stock analysts, brokers recommending curtailing of sales of Baldwin SPDAs, restructuring of short-term debt because of inability to meet payments when due, forecasts of

Baldwin's present and future financial difficulties, lack of agreement among Baldwin creditors to extend Baldwin debt due and past due, lowered Standard & Poor's ratings on Baldwin debt, a very short extension of debt being granted by Baldwin's creditor banks for the purpose of allowing them to determine whether Baldwin's finances justified a further extension of time to pay, Baldwin's announcement of substantially lower earnings, Baldwin's requests to banks to postpone repayment while it attempted to work on a debt repayment plan, announcement by Baldwin of a 1982 fourth quarter loss of $2.8 million, net income of substantially less than in 1981 and failure to make promised payment to a creditor which raised doubt that Baldwin would be able to reschedule its short-term debt.

From the complaint and the numerous exhibits submitted below it would be an understatement to claim that there were sharply contested issues of fact as to the extent of defendants' knowledge of Baldwin's financial difficulties, as to when defendant was put on notice as to these difficulties and as to the effect of these difficulties on Merrill Lynch's announced earnings. The complaint, together with the exhibits annexed thereto, sufficiently stated a detailed claim for violation of § 10(b) and could and should have led the Court of Appeals to reverse the District Court's granting of summary judgment.

The procedural history of this action begins with the filing of the complaint on February 1, 1984, shortly after Merrill Lynch announced huge material writeoffs affecting its previously disseminated financials.

Defendants, by motion filed April 20, 1984, pursuant to Rules 9(b) and 12(b) of the F.R.C.P., moved to dismiss plaintiff's complaint for failure to plead fraud with particularity. On June 1, 1984, plaintiff filed his memorandum of law in opposition to defendants' motion. The Court, by Order dated July 27, 1984, converted defendants' motion into a motion for summary judgment (A-1-3). On August 22, 1984, plaintiff filed his amended complaint, as of right. Defendants, by amended notice of motion, moved to dismiss the amended complaint on the same grounds, for failure to plead fraud with particularity (emphasis added). Limited discovery, duly sought in order to enable plaintiff to oppose the summary judgment motion, was denied and none has been had (A-4-5). The Court, in granting summary judgment to defendants, despite the detailed factual allegations and exhibits,

and despite the sharp issues of fact raised, dismissed the complaint on October 10, 1984, characterizing it as "fraud by hindsight" and stated that to allow discovery would be equivalent to permitting a "fishing expedition" (A-6-8). Judgment was entered on October 18, 1984 (A-9-10). Plaintiff's motion for reargument or reconsideration of the stay of discovery was denied on November 9, 1984 (A-11-14).

On December 10, 1984, plaintiff filed his Notice of Appeal. In January 1985, plaintiff obtained two documents, a "Notice of Intent to Issue an Adjudicatory Order and of Respondent's Right to Hearing," issued by the State of Ohio, Department of Insurance (A-92) and the "Examiner's Statement of Investigation", issued to the Bankruptcy Court for the Southern District of Ohio, Western Divi-

sion (A-133), which came into existence wich came into existence after the District Court's dismissal of plaintiff's complaint, and after the filing of plaintiff's Notice of Appeal.

Plaintiff moved, pursuant to F.R.C.P. Rule 60(b), for Relief From Judgment or Order Based upon Newly Discovered Evidence, dated February 5, 1985. The motion was denied by the District Court on March 8, 1985 (A-15-16).

Plaintiff then sought, by motion dated March 19, 1985, to expand the record on appeal by including in the Joint Appendix the two documents referred to in the 60(b) motion, supra, as well as two additional documents which later came into existence, the Motion of the State of Maine, as Amicus Curiae, "In Opposition to Proposed Class Action Settlement" (A-149) and the "Memorandum of the Amici States in Opposition to

Proposed Class Action Settlement" (A-165), both filed in the District Court for the Southern District of New York, or, in the alternative, to have the Court of Appeals take judicial notice of these documents (A-73). Plaintiff's motion was denied on March 25, 1985 (A-17-19).

Had the court taken judicial notice of these documents, the allegations of plaintiff's complaint as to defendants' knowledge of Baldwin's grave financial difficulties, and as to defendants' own exposure at the time Merrill Lynch was claiming record profits, would have been even further buttressed (A-80-89).

One of these documents, Baldwin's "Examiner's Statement of Investigation" specifically states that Morley Thompson's (Baldwin's Chief Executive Officer) recollection of events, if substantiated "would furnish the basis for a major claim by the company [Baldwin] against

Merrill Lynch." (A-143). It further states that if certain "assumptions are correct, Merrill Lynch -- by letting objectivity yield to self-interest and by permitting itself to be used as a means of tying down financing for the acquisition [of MGIC] -- bears a share of the damage that has been done to the Debtors in these proceedings." (A-147-148).

Thus, it clearly appears that Merrill Lynch was well aware of the liability it faced.*

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* Since the dismissal of this action, the Attorneys General for the various states opposing the proposed $135 million class action settlement ($44 million to come from Merrill Lynch, the largest SPDA seller) on behalf of Baldwin SPDA holders (A-165) have appealed the District Court's approval of the settlement. The appeal to the Second Circuit was filed on or about May 31, 1985 and is pending as of the date of filing of this Petition.

Excerpts from this and the other three excluded documents, to which the Circuit Court was referred and to which this Court is respectfully referred (A-92-207), and all of the documents placed before the Courts below, reveal that at the time Merrill Lynch announced record first and second quarter earnings for 1983, it knew or should have known of at least the following: that it had engaged in deceptive practices in the sale of unregistered securities (Baldwin SPDAs); that its sales of such securities were made through materially false statements to purchasers of the SPDAs, including the description of the SPDAs by Merrill Lynch to purchasers as being safe, guaranteed and risk-free investments; that Merrill Lynch's probability of collection of Baldwin's debt to it was highly dubious in view of its awareness of

Baldwin's shaky financial resources; and that Baldwin's pending insolvency would have a drastic impact on Merrill Lynch's reported "record" earnings and future operations.

The Second Circuit affirmed the District Court and granted summary judgment to defendants on April 8, 1985 (A-20-23).

REASONS FOR GRANTING THE WRIT

1. The conflict between the Second Circuit's rigid application of the pleading requirements for fraud under Rule 9(b) as compared to requirements employed by other circuits, affords this Court an opportunity to decide a question not previously ruled upon by the court, which is the subject of division among the circuits and of intense scholarly debate.

Rule 9(b) states that all averments of fraud must be alleged with particularity (A-210). However, there is no set guideline to facilitate the determination of exactly what constitutes sufficient particularity. Hence, a split of authority, as demonstrated by the Second and Third Circuits, has evolved among the courts.

The Court below, in affirming the judgment of the district court, premised its opinion on Denny v. Barber, 576 F.2d

465 (2d Cir. 1978). The Second Circuit, in Denny, adopted a rigid interpretation of Rule 9(b) and labelled the allegations as constituting "fraud by hindsight." Denny v. Barber, supra, 576 F.2d at 470. The Court below applied this amorphous and ill-defined phrase to the instant case, as well.

The Third Circuit, has long rejected Second Circuit opinions, as espoused by Denny v. Barber, supra, and applies Rule 9(b) in a more flexible manner. The Third Circuit aptly stated in Christidis v. First Pennsylvania Mortgage Trust, 717 F.2d 96, 99 (3rd Cir. 1983), that it "finds more appropriate guidance [in 9(b) matters] . . . closer to home."*

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* The Pennsylvania District Court in interpreting Christidis stated that ". . . the Third Circuit declined to follow Decker [Decker v. Massey-Ferguson, Ltd., 681 F.2d 111 (2d

(continued on next page)

The split of authority is also reflected in many District and Circuit Court cases. These cases are closely analyzed in Note: Pleading With Particularity, 97 Harv. L. Rev. 1432 (1984) ("Harvard Note") and Sovern, Reconsidering Federal Civil Rule 9(b): Do We Need Particularized Pleading?, 104 F.R.D. 743 (1985) ("Sovern").

The great disparity between pleading requirements under 9(b) in the Second Circuit and other c.rcuits is demonstrated by cases such as Walling v. Beverly Enterprises, 476 F.2d 393, 397 (9th Cir. 1973), where the Ninth Circuit stated that while the circumstances

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* Cir. 1982)] and similar [Second] Circuit] cases, [e.g., Denny v. Barber] counseling a restrictive view of 9(b)." Thomas v. Tramiel, Fed. Sec. L. Rep. (CCH) ¶92,030 at 91,123, n.2 (E.D. Pa. April 15, 1985).

constituting fraud must be alleged with particularity, the rule does not require the pleading of detailed matters; instead, "[i]t only requires the identification of circumstances constituting fraud so that defendants can prepare an answer"; Christidis v. First Pennsylvania Mortgage Trust, 717 F.2d 96, 100 (3rd Cir. 1983) ("focusing exclusively on particular langauge is too narrow an approach and fails to take into account the general simplicity and flexibility of the rule"); Kitchens, et al. v. U.S. Shelter Corp., et al., Fed. Sec. L. Rep. (CCH) ¶91,838 (D.S.C. 1984) where the District Court, articulating the view of the 4th Circuit, stated:

> The defendants rely on authority from the Second Circuit, which has dismissed various cases on the ground of insufficient particularity. . . . The Fourth Circuit, however, has refused to adopt these stringent pleading requirements. . . . [A] motion

> to dismiss will be denied unless it appears to a certainty that no possible set of facts could be proved to support plaintiff's claim. It is clear that in this circuit Rule 9(b) must be read in light of Rule 8.

Id. at 90,200 (citations omitted); Carroll v. First National Bank of Lincolnwood, 413 F.2d 353 (7th Cir. 1969) cert. denied, 396 U.S. 1003 (1970) (rule 9(b) is not intended to abrogate basic pleading requirements of Rule 8(a)); U.S. v. Gill, 156 F. Supp. 955 (W.D. Pa. 1957) (fraud is not required to be pleaded with absolute and detailed particularity); Whittlin v. Giacalone, 154 F.2d 20 (D.C. Cir. 1946) (all that is required is that circumstances be pleaded with sufficient definiteness as to advise the adversary as to the claim he must meet); Lewis v. Berry, Fed. Sec. L. Rep. (CCH) ¶91,403, 98,014 (W.D. Wash. 1984) ("The Ninth Circuit has adopted a less

strict interpretation of Rule 9(b) than has the Second Circuit"); Zatkin v. Primuth, 551 F. Supp. 39, 42 (S.D. Cal. 1982) (exclusive focus on the fact that Rule 9(b) requires particularity in pleading "is too narrow an approach and fails to take account of the general simplicity and flexibility contemplated by the rules"). Furthermore, the Eleventh Circuit has attempted to harmonize rule 9(b) with the broader policy of the F.R.C.P., which "reject[s] the approach that pleading is a game of skill in which one misstep by counsel may be decisive to the outcome and accept the principle that the purpose of pleading is to facilitate a proper decision on the merits." Friedlander v. Nims, 755 F.2d 810, 813, n.3 (11th Cir. 1985) (quoting, Conley v. Gibson, 355 U.S. 41, 48 (1957)).

In contrast, the Second Circuit has adopted an extremely restrictive and

inflexible approach to pleading securities fraud under 9(b). In Denny v. Barber, supra, the court required that plaintiff's complaint state specific paragraphs in documents that were alleged to be false, exact transactions, and describe such items as loans, including exact amounts of the loans that plaintiff considered "risky." 576 F.2d at 469. The Second Circuit recognized that other courts sustained complaints no more specific than the complaint in Denny. However, the court stated that it would follow its own decisions. 576 F.2d at 469.*

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* Plaintiff submits that, even if Denny v. Barber establishes the pleading standards under 9(b), the facts as pleaded in this case are clearly adequate under any standards. Goldman v. Belden, 754 F.2d 1059, 1069 (2d Cir. 1985). Thus, the "fraud by hindsight" label does not fit the instant facts.

This Court has repeatedly emphasized that "private securities actions provide 'a most effective weapon in the enforcement' of the securities laws and are 'a necessary supplement to Commission action.'" Bateman, Eichler, Hill, Richards, Inc. v. Berner, 53 U.S.L.W. 4737, 4740 (U.S. June 11, 1985) (No. 84-679) (quoting, J.I. Case, Co. v. Borak, 377 U.S. 426, 432 (1964)). The incongruous result engendered by the different standards for applying 9(b) hinders and ultimately defeats this policy. It encourages forum shopping and inequitable administration of the law, Sovern, supra, at 164; it delays litigation while parties argue about the sufficiency of the complaint; and it results in colorable cases being dismissed because pleaders cannot measure up to the standards created by an excessively rigid interpretation of the Rule. Id. at 150.

In the instant case, it is our contention that the rigid requirements of the Second Circuit concerning Rule 9(b) resulted in the unfair dismissal of a meritorious claim.

2. The complexity of contemporary fraud transactions requires a flexible application of rule 9(b), which is not followed by the Second Circuit, and which should be followed to ensure that meritorious claims are heard.

A strict application of Rule 9(b) does not further its underlying policies or the underlying policies of the Federal Rules.* Instead, it invites complicated pleading requirements, increased litigation and motion practice and hasty dismissals. Rule 9(b), created in 1937, was developed in order to reflect the common law rules of fraud pleading. Historically, fraud was a disfavored cause of action and common law rules required great particularity. Roberts, Fact Pleading, Notice Pleading and

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* Rule 1 of the Federal Rules requires that: "They shall be construed to secure the just, speedy, and inexpensive determination of every action." (A-209-210).

Standing, 65 Cornell L. Rev. 390, 395 (1980); Clark, Cases on Modern Pleading, 59 (1952). Fraud claims at common law grew out of disputes concerning fairness of face to face business transactions such as when a seller of goods misrepresented facts material to the value of such goods. In most contemporary securities fraud cases, however, plaintiffs have only indirect contact with defendants through impersonal market channels. Such conditions make it difficult for a plaintiff to plead with great particularity the details of an alleged fraud transaction. Harvard Note, supra, at 1436.

Rule 9(b) rests on three policies: desire to protect the reputations of innocent defendants; minimize strike suits; and provide notice to adverse parties. Sovern, supra, at 164. A review of these policies through the

application of Rule 9(b) reveals that a strict application does not necessarily encourage these goals.

Rule 9(b) is said to increase protection of reputations by deterring plaintiffs from filing complaints. Sovern, supra, at 171. A strict application of Rule 9(b), however, does not prevent unscrupulous plaintiffs from filing in the hope that the defendant will not challenge the complaint for insufficiency. Harvard Note, supra, at 1440. A strict application may have a chilling effect upon honest plaintiffs, who will be deterred from filing meritorious complaints for fear of not meeting 9(b) requirements. A more flexible application, however, will permit the case to at least reach the discovery stage so that an adequate determination of whether a claim is meritorious can occur.

Prospective harm to reputation depends on the assumption that vindication of the defendant in the public's eye will occur if the allegations are dismissed at the pleading stage. The public may look at such an early dismissal, however, as vindication through mere technicality. Sovern, supra at 172. Moreover, the reputation of a defendant may be so harmed by prior litigation that new litigation will not have a serious effect. In the instant case, defendants cannot suggest that a dismissal of the complaint protects their reputation. Some 51 lawsuits were filed in the federal courts against Merrill Lynch, Pierce, Fenner & Smith and other brokerage firms for improper conduct in the sale of Baldwin SPDA's. In addition, Shapiro v. Merrill Lynch & Co., Inc. and Merrill Lynch, Pierce, Fenner & Smith, Inc., C-1-85-0625 (S.D.

Ohio, W.D. filed March 1, 1985) was filed on behalf of Baldwin shareholders against Merrill Lynch.

The special requirements for pleading fraud under 9(b) create a situation of inequitable treatment of defendants under the law. Allegations of intentional torts such as assault, battery, false imprisonment, even allegations of gross negligence, impair a defendant's reputation. These allegations, however, are not pleaded with particularity. Sovern, supra, at 173. If the Federal Rules are designed to protect reputation, they should do so with consistency.

It is questionable whether Rule 9(b) should even elevate protection of reputation to such importance because of the substantive rights clause of the Rules Enabling Act (A-215-16). The Act serves as a reminder to minimize the substantive impact of the federal rules.

This argument is supported both by the Act itself, and its legislative history. 19 Wright, Miller and Cooper, Federal Practice and Procedure § 4509 at 139-140, n. 11 (1982). Justification for Rule 9(b) should more properly rest on rationales such as avoidance of strike suits and adequate notice. Even these goals, however, demonstrate that an unyielding application of Rule 9(b) is not necessary.

Deterrence of strike suits is a laudable goal. However, a stringent application of 9(b) creates greater difficulties than it cures. Some courts characterize Rule 9(b) as a rule requiring that facts be specific enough to insure that the plaintiff has adequately investigated the alleged fraud. The premise behind these opinions is that a complaint should seek to redress a

wrong, not find one. McGinty v. Beranger Volkswagon, Inc., 633 F.2d 226, 229 n.2 (1st Cir. 1980); Segal v. Gordon, 467 F.2d 602, 607-08 (2d Cir. 1972). The problem with this rationale is that these courts fail to consider the practical difficulties that plaintiffs encounter in acquiring factual details. Often, specific indications of securities fraud are hidden in internal memoranda, business projections and other records that are not easily obtainable. The Harvard Note aptly states:

> Few courts have explicitly considered . . . the practical difficulties in piercing the shroud of secrecy that surrounds most capital market transactions. Harvard Note, supra, at 1439.

Furthermore, the Federal Rules of Civil Procedure have other control mechanisms. Rules 16 (A-211-12) and 26(b) (A-212-13) enable judges to

limit the scope of discovery and Rule 56 allows for review of discovery material prior to dismissal (A-213-15). Here, plaintiff was denied even limited discovery (A-4-5, 6-8, 20-23).

A strict application of Rule 9(b) conflicts with the requirements of Rule 8 (A-210). The basic principle behind Rule 8 and the Federal Rules of Civil Procedure is to simplify the pleading process. Id. at 149. The plaintiff must only plead enough information so that the defendants can adequately respond to the allegations. The plaintiff need not plead evidence. Defendants can generally admit or deny allegations without the plaintiff supplying a list of details. Harvard Note, supra, at 1444. If the defendant is not able to respond, he can make a 12(e) motion for a more definite statement (A-211).

Rigid requirements of detailed factual pleadings invite hasty dismissals of meritorious claims and an increase in litigation while the plaintiff tries to amend the complaint to satisfy the Court's perceived interpretation of Rule 9(b). Harvard Note, supra at 1442.

3. Plaintiff's complaint and exhibits, having raised issues of fact concerning defendants' failure to disclose its liability for Baldwin-related transactions, such facts being peculiarly within the knowledge of defendants and discovery having been denied, should not have been dismissed by summary judgment.

Plaintiff was not required to prove any of the allegations of his complaint to defeat a motion for summary judgment. The question before the Circuit Court was whether triable issues of fact had been raised. This Court has recently reaffirmed its holding in Conley v. Gibson, 355 U.S. 41, 45-46 (1957), that "a court may dismiss a complaint only if it is clear that no relief could be granted under any set of facts that could be proved consistent with the allegations." Hishon v. King & Spalding, 104 S. Ct. 2229, 2233 (1984).

At bar, no affidavit was made in support of defendants' motion by any person having knowledge of the facts. No facts at all were set forth by defendants. The Circuit Court granted summary judgment upon the complaint, and exhibits annexed thereto and the exhibits furnished in support of and in opposition to the motion. The granting of summary judgment had to be based upon the inferences the Court drew from the documents before it, which are indeed susceptible to different interpretations. Such inferences the Court may not draw. It was not the trier of fact. Reasonable minds may differ.

The court's error was further compounded by denial of discovery.

Plaintiff alleges that defendants knew of their vast exposure to Baldwin prior to their first and second quarter 1983 reports of record earnings and

continued strength, which were relied on by plaintiff when he purchased. It is respectfully submitted that no court, without the benefit of additional facts flushed out by discovery, could summarily rule that "no relief could be granted under any set of facts that could be proved consistent with [these] allegations." Hishon v. King & Spalding, supra, 104 S. Ct. at 2233; accord, Adickes v. S.H. Kress & Co., 398 U.S. 144, 157 (1970); 6 J. Moore and J. Wicker, Moore's Federal Practice, ¶56.23, 1387, 1389-90 (2d Ed. 1982).

In a private civil action brought to enforce defendants' liability under the securities laws, where the facts are peculiarly within the knowledge of the defendants, "plaintiff is entitled to a trial." Subin v. Goldsmith, 224 F.2d 753, 757 (2d Cir.), cert. denied, 350 U.S. 883 (1955).

Subin held that where evidence must come largely from the defendants, where contrary facts are peculiarly within the opponents' knowledge and where a complicated state of facts exists, summary judgment should be denied. 224 F.2d at 757-58.

In Schoenbaum v. Firstbrook, 405 F.2d 215, 218 (2d Cir. 1968) (en banc), cert. denied, 395 U.S. 906 (1969) the Second Circuit stated that "issues as to the knowledge, intent, and motive" of defendants require a full trial. In describing the instant case as "fraud by hindsight", it appears that the Circuit Court found as a fact that defendants could not have had scienter in spite of the factual evidence submitted. The allegations concerning the individual defendants' intimate knowledge and the sources of plaintiff's information were repeatedly set forth in the complaint.

Defendants are the only ones who knew their motive, intent and scienter concerning the impact that their sales of Baldwin SPDAs would have upon Merrill Lynch's financials. It defies belief that other brokerage houses, with far less knowledge of Baldwin and its subsidiaries, ceased selling Baldwin SPDAs while Merrill Lynch rolled along, racking up its "record" earnings.

Defendants claimed that the earnings reflected set records in the first quarter and again in the second quarter. Merrill Lynch announced a 2-1 stock split, its dividend was raised and defendant Birk stated that Merrill Lynch would "live and thrive whatever the rules" (A-58). In short, defendants reported record earnings and profits, and prophesied a continuation thereof. At the same time they omitted to disclose that Merrill Lynch faced large

losses as a result of the wrongful acts and practices it engaged in concerning the sales of Baldwin SPDAs. They omitted to disclose that the collection of Baldwin's $90 million indebtedness to them was highly doubtful. As a result, Merrill Lynch's financials were overstated and misleading.

Did defendants' failure to make public its exposure to Baldwin SPDA purchasers meet the fraud requirements sufficient to impose liability under § 10(b) at the time of the above-referenced reports? If so, then the court's "fraud by hindsight" finding has been refuted. To resolve this question, one must determine defendants' motive, intent and knowledge concerning its disclosure, or lack of disclosure, about its Baldwin relationship.

In an attempt to ascertain the motive, intent and knowledge of defend-

ants and to "prove" defendants' scienter, from sources other than those publicly available, plaintiff noticed discovery. The limited discovery sought was particularly stated to be "in support of plaintiff's opposition to defendants' motion for summary judgment" and to "use the same on defendants' motion for summary judgment, now pending."

The District Court thereafter granted defendants' summary judgment and denied discovery (A-6-8). The Circuit Court affirmance agreed with the denial of discovery (A-20-23).

We believe that the granting of the motion for summary judgment was error for the reasons hereinabove set forth, including the denial of plaintiff's motion to take judicial notice of the exhibits setting forth further facts as

to defendants' awareness of its fraudulent conduct prior to plaintiff's purchases. When the granting of the motion for summary judgment was accompanied by a denial of discovery, the error was compounded.

The Second Circuit has repeatedly held that in complex securities litigations summary judgment should rarely be granted. Schoenbaum v. Firstbrook, supra, 405 F.2d at 218; Subin v. Goldsmith, supra; Colby v. Klune, 178 F.2d 872 (2d Cir. 1949); Fogelson v. American Woolen Co., 170 F.2d 660 (2d Cir. 1948); see also, Poller v. Columbia Broadcasting System, Inc., 368 U.S. 464 (1962) (antitrust). It has likewise been repeatedly held that this general maxim is even more stringently applied when no discovery has been had. Schoenbaum v. Firstbrook, supra; Subin v.

Goldsmith, supra. Gary Plastics Packaging Corp. v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 756 F.2d 230, 236 (2d Cir. 1985) ("The harshness of the [summary judgment] remedy is exacerbated when the trial court refuses to allow plaintiff to conduct discovery").

In Schoenbaum, it was stated:

> The district court's grant of summary judgment against the plaintiff was accompanied by a refusal of his request for discovery. This court has indicated that summary judgment should rarely be granted against a plaintiff in a stockholder's derivative action especially when the plaintiff has not had an opportunity to resort to discovery procedures. The plaintiff typically has in his possession only the facts which he alleges in his complaint. Having little or no familiarity with the internal affairs of the corporation, he is faced with affidavits setting forth in great detail management's version of what actions were taken and what motives led the affiants to take these actions. Since the facts in such a case are exclusively

> in the possession of the defendants, summary judgment should not ordinarily be granted where the facts alleged by the plaintiff provide a ground for recovery, at least not without allowing discovery in order to provide plaintiff the possibility of counteracting the effect of defendants' affidavits. Indeed, in many stockholders' derivative actions there will be issues as to the knowledge, intent and motive which will require a full trial with an opportunity to observe the demeanor of the witnesses, and to conduct cross-examination in open court. In such cases summary judgment cannot be granted even after discovery has been had.

405 F.2d at 218 (citations omitted) (emphasis added).

Schoenbaum has since been cited with approval by the Second Circuit in an action brought under § 10(b). Wechsler v. Steinberg, 733 F.2d 1054, 1059 (2d Cir. 1984).

The observation made by Judge Learned Hand in Bozant v. Bank of New York, 156 F.2d 787 (2d Cir. 1946)

is particularly apropos:

> In conclusion we cannot avoid observing that the case is another mistaken effort to save time by an attempt to dispose of a complicated state of facts on motion for summary judgment. This is especially true when the plaintiff must rely for his case on what he can draw out of the defendant. It appears to be somewhat difficult to persuade the district courts of this; but we are satisfied that it is true. (Citation omitted).

Id. at 790.

CONCLUSION

It is respectfully submitted that the facts pleaded and referred to in the complaint, are sufficient to satisfy Rule 9(b). At the same time, these facts, if true, as plaintiff should have the opportunity to prove, raise material issues of fact as to Merrill Lynch's fraudulent conduct by its failure to

disclose its exposure as a result of its intimate and detailed involvement in the affairs of Baldwin, prior to plaintiff's purchases. Based on the facts alleged, and materials submitted below, the granting of summary judgment constituted reversible error.

For the foregoing reasons, it is respectfully submitted that this petition for a writ of certiorari should be granted.

Respectfully submitted,

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